

Fiscal Federalism in Nigeria: An Analysis of Issues and Challenges

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Abstract

The paper posits that fiscal federalism is a particular pattern of constitutional division of revenue powers and responsibilities among levels of government. The federal government however has occupied a very strong position vis-à-vis the State and Local government since the 1970's in Nigeria. This is because most of the power (financial and legislative) relating to economic development has been explicitly centralized at the federal level. It is the position of the paper that a high level of fiscal decentralization is required in Nigeria because of the unfair revenue sharing formula and the need to resolve the controversial issues surrounding the contentious fiscal federalism in Nigeria. Apart from recommending a substantial review of the fiscal system, it draws attention to the political imperatives of a constitutional modification of the fiscal arrangement and adequate compensation for those who produce the 'commonwealth' among others.

KEY WORDS: Federalism, Fiscal Federalism, Fiscal Decentralization, Resource Control

Introduction

The term fiscal federalism itself is rooted in a political arrangement called federalism. It is therefore, imperative to start with an explanation of the concept of federalism. Wheare (1963) describes federalism as the method of dividing powers so that general and regional governments are each within a sphere, coordinate and independent. Federalism implies the existence in one country of more than one level of government, each with different expenditure responsibilities and taxing powers. It is a kind of non-centralization of power and authority. It is about equality, and equity, justice and fair play amongst constituent units and between the units and the central government. However, in Nigeria, due to its peculiar evolution, the federal system tends to emphasize not cooperation but competition between the constituent units and the centre and amongst the constituent units themselves (Jega, 1996:89).

In light of the foregoing, fiscal federalism refers to the financial relationships among existing tiers of government. In other types of political structure it is known as intergovernmental fiscal relations. Sometimes, both terms are used interchangeably. Specifically, it is the system of transfers or grants by which the federal government shares its revenues with states and local government. It implies the disposition of tax powers, retention of revenue and method adopted in sharing centrally collected revenue in accordance with the constitutional responsibilities of all the levels of government. It also covers the principles and formula of sharing the centrally collected revenue among the individual states and local governments. This system is what is generally referred to as revenue allocation which is a mechanism used to address the fiscal imbalances which emerge in the process of economic development.



Fiscal federalism has a long history in Nigeria. It dates back to 1946 when the Richards constitution was introduced. Over the years fiscal commissions were appointed to work out fiscal and financial arrangements that were consistent with assignment of powers and responsibilities to each level of government. The idea was that each level of government should have adequate funds to effectively and efficiently discharge its responsibilities. Suffice it say that Nigeria's fiscal federalism has emanated from historical, economic, political, geographical, cultural and social factors. In all of these, fiscal arrangements remain a controversial issue since 1946 (Ekpo, 2004).

Therefore, there exist unresolved issues on this matter. The introduction of a democratic experiment in 1999 re-echoed the problems of intergovernmental fiscal arrangement among the different levels of government with the issue of resource control coming to the front burner. The interference by the executive arm of government on the functions of the National Revenue Mobilization and Fiscal Commission (NRMFC) on the appropriate revenue-sharing formula among the different levels of government, the debate regarding the correct interpretation of the section of the 1999 constitution affecting the derivation principles among others have posed challenges for Nigeria's fiscal federalism. This paper carefully examines fiscal federalism in Nigeria within the context of its evolution, principles, the political economy and the challenges posed by the practice of fiscal relations in Nigeria.

Fiscal Federalism: A Review

The term "fiscal federalism" is rooted in a political arrangement called federalism as already attested to in our introduction. It is the financial relationships between and among existing tiers of government. Specifically, it is the system of transfers or grants by which the federal government shares its revenues with state and local governments. This is what is generally referred to as revenue allocation.

The procedure for revenue allocation is hinged on a number of factors which may be within or outside the control of the people in each locality. For instance, perhaps by some natural or man-made designs, nations have emerged through the combination of pre-existing sovereign jurisdictions which then join into national units. In any case, member jurisdictions (e.g. States) may retain certain fiscal prerogatives while surrendering others, there by joining in a compact which determines the fiscal aspects of the federation (Musgrave and Musgrave, 1973).

The fiscal relationships between and among the constituents of the federation can be explained in terms of three theories, namely, the theory of fiscal location which concerns the functions expected to be performed by each level of government in the fiscal allocation; the theory of inter-jurisdictional cooperation which refers to areas of shared responsibility by the national, state and local governments; and the theory of multi-jurisdictional community. In this case, each jurisdiction (state, region or zone) will provide services whose benefits will accrue to people within its boundaries and so, should use only such sources of finance as will internalize the costs. The revenue sources of most control governments are limited but cover a range of taxes and levies. These include personal income tax, tariffs, company or corporate income tax, excise duties, custom duties, and royalties or levies on natural resources. The contributions of each of these to the total revenue depend on a number of factors which include efficiency of tax collection method, enforcement of violation penalties, the size of the economy itself with

respect to the level of employment, industrialization and income, the level of integration of the informal sector with the formal, and a host of other economic and socio-cultural factors.

State and local governments (or their equivalents) derive their revenues from more limited and more austere services. These include personal income tax, poll tax, sales tax, property tax, licenses, permits etc. These are supplemented by transfers from the central or federal government. In most cases, a revenue sharing formula is adopted for determining how much of the federally collectible revenue goes to each level of government. The proportion of transfers that goes to the lower tiers of government depend largely on the system or structure of governance, availability of revenue base and ability to generate revenue internally.

Under the centrally planned economy, as existed in pre-Gorbachev Union of Soviet Socialist Republics (USSR), the Eastern bloc as well as Cuba, the issue of revenue allocation did not arise. All incomes, including profits and royalties, went into a common purse administered by the central government. The actual value of revenues before the reforms of the mid 1980's and the current transition to market economy in these erstwhile communist countries were shrouded in secret since the beginning of the reforms, however, the central governments have lost control and the provincial or state enterprises have acquired the power to withhold part of the proceeds of state enterprises. Infact, this reform started in China as far back as 1978 where apart from the reductions in remittances from State enterprises, other economic factors such as declining demand for products, withholding of products taxes, turnover and value added tax by the lower-level governments affected the federal or central government revenue (Blejer and S. Zapary 1989; McKinnon 1991). In fact; the reform period resulted in the rise of provincial power in China, as the Central government shrank in its control of materials and commodities in resource allocation and thereby put more money into the treasury of the provinces.

In the case of the United States – like many other capitalists and industrialized countries – the lower levels of government have an efficient tax system and are able, through this mechanism, to generate a larger proportion of their revenues from taxes. However, the revenue usually falls short of their expenditures and the balances is provided through transfers from the federal government. McConnell and Brue (1990) posit that federal allocations to states and local governments in the United States account for between 15 and 20 percent of their budgets. In addition, the States do make grants to the local government units. In developing countries like Nigeria, studies have shown that the state and local governments rely mainly on allocations from the federal government (Ekpo, 1994; Olowononi 1998). The allocation from the federal government usually constitutes about 70 to 90 percent of the state or local government revenues. Some major implications of this dependence are that the situation of the local governments would be worse; the agitation for constant review of revenue allocations in favour of the States and local governments will persist and continue to be a major friction in the political equation of the country. Moreover, the States will remain inefficient in tax collection and consequently remain underdeveloped in tax and general revenue administration. All these will continue to generate unnecessary tension (Tella, 1999) as the case with Nigeria.



Evolution of Nigeria's Fiscal Federalism

Nigeria's fiscal federalism is anchored on economic, political, constitutional, social and cultural development. As Nigeria progressed from a unitary to a federal type of government, the form of government became more and more decentralized; there were changes in fiscal arrangements (Ekpo, 2004).

Before the amalgamation of Nigeria in 1914, the component units, the protectorate of Northern Nigeria, the protectorate of Southern Nigeria and the Colony of Lagos-each enjoyed complete fiscal independence. Also before the amalgamation, a unified fiscal system had already been in place while a centralized budgeting system was introduced in 1926. However with the adoption of regionalism in 1946, a decentralized fiscal structure was evolved. Before the introduction of a republican constitution in 1963, the fiscal arrangements were influenced by political and constitutional factors. Several commissions were created to renew existing fiscal arrangements and make appropriate recommendations (Ekpo and Ndebbio, 1996). These were (i) Sir Sydney Phillipson; 1947, (ii) Hick & Phillipson; 1951, (iii) Chick Commission; 1954, (iv) Ransman Commission; 1957, (v) Binns Commission; 1964, (vi) Dina Commission; 1968, (vii) Aboyade Technical Committee; 1977, (viii) Okigbo Committee; 1981, and (ix) Danjuma Commission; 1989. New formula was also introduced in 1990 and 2000 (Dunmoye, 2002). Each of these commissions came up with their own distinct contending criteria as to how the revenues in the country are to be shared. However, it needs to be pointed out that none of the commissions' recommendations were completely accepted by government.

With the enthronement of democracy in 1999, controversies regarding the country's fiscal operations took a new turn with the Federal Government been accused by oil producing states for not honouring the derivation principles as stated in the 1999 federal constitution. These made the Federal Government to introduce the on-off shore dichotomy implying that oil found in the sea cannot be ascribed to the adjoining state. The on-off shore controversy resulted in states in the Niger Delta calling for a greater control of their resources (Petroleum). This led to the struggle for resource control culminating in some states suing the Federal Government with the matter ending in the Supreme Court.

It should be noted that the National Revenue Mobilization, Allocation and Fiscal Commission (NRMAFC) which was inaugurated in 1990 become effective during this period. The NRMAFC rejected on several occasions the interference of the President and the Federal Ministry of Finance on the formula for revenue sharing. The NRMAFC insists on the proper interpretation of the constitution. For example in January, 2004, the federal Ministry of finance in a letter to the Commission gave the Federal Government a share of 54.68% and a grant of 2% of the states. The NRMAFC disagreed with the Ministry of its non-compliance with the provision of section 164(1) of the 1999 Constitution (Akpo, 2004). From the foregoing, it is clear that Nigeria fiscal federalism is still metamorphosing and evolving.

Principles of Fiscal Federalism

The problem of devising an appropriate formula that is acceptable to all the regions/states emerged as soon as Nigeria accepted federalism in the early 1950's. Since then, several fiscal commissions/committees had been appointed to work out an equitable formula for sharing revenue among them. Many principles had been introduced and applied to revenue sharing among States consequent upon the commissions and committees highlighted earlier, yet the problem of equitable revenue sharing remain unresolved.



In Nigeria, certain basic principles are used for revenue allocation. They can be subsumed under three broad heading namely: (a) Derivation (b) Need and (c) National Interest/Even Development. Other, but with less emphasis are (i) population (ii) geographical peculiarities (iii) absorptive capacity, (iv) internal revenue efforts (v) equality of States (vi) continuity (vii) fiscal efficiency (viii) national minimum standards for national integration (ix) Land mass and (x) financial comparability (Dunmuye, 2002).

Evidently, the general principles of fiscal federalism seemed to have informed the Nigerian experimentation with different principles dictated by the miscellany of historical exigencies and peculiarities of a developing political system. From Phillipson Commission (1946) through Rausman (1958) to Binn's (1964), the derivation and consumption principles were considered the most important factors while population was indirectly introduced as a means of allocating federal block grants to the regions.

Between 1947 and 1970 the two contending principles which guided revenue allocation in Nigeria were derivation and need, derivations having the advantage. The argument in support of derivation is often made for retention of the tax revenue generated by the area of origin. The derivation principle requires that the component units of a federation be able to control some of their preferences in their own way with their own resources on the other hand, the principle of need is based on the number of adult male tax payers. The Rausman Commission (1958) on revenue allocation widened the base of the principle of need to include such factors as population, basic responsibility of each regional government, the need for continuity in regional public service and the need for balanced development.

In 1970, as a result from the oil wind fall, the Federal Military Government of General Yakubu Gowon promulgated Decree No 3 which increased financial allocation to the Federal Government and reduced export duties that went to the States from 100% to 60%. The Federal Government also took over many functions of the State Governments like primary and tertiary education. From then on, the principle of derivation was gradually jettisoned. There is no gain saying the fact that the demand for resource control now is the extreme case of an indirect clamour for a return to the principle of derivation.

It should be noted that the various principles highlighted in the foregoing discussion are not mutually consistent. They are difficult to apply simultaneously. Therefore, tradeoffs are necessary in order to avoid conflicts. There is no doubt that the general principles of fiscal federalism appeared to have informed Nigeria's attempt at intergovernmental fiscal relations and the different principles have been dictated by a combination of historical, experiences, political, cultural and social factors. It is therefore apt to assert that the revenue allocation formula/principles in Nigeria is a phenomenon that appears to be in permanent disorder. The ad-hoc and inconsistent revenue allocation principles adopted by various Nigeria governments partly explains the frequent creation or the need for new revenue allocation commission.

The Political Economy of Fiscal Federalism in Nigeria

The nature and conditions of the financial relations in any federal system is crucial to the continued existence of such system. Fiscal matters transcend the purview of economics. They have in most cases especially in plural societies like Nigeria assumed political, religious and social dimensions. The political economy of fiscal federalism confronts the power relations that



underline the authoritative allocation of resources among the various tiers of the Nigerian federation. By the same logic, it deals with the outcomes of the allocative process and the conditions under which it breeds crisis.

According to Dunmoye (2002), four interrelated factors can initiate or ruin a viable federation. These are:- the issue of political power sharing or representativeness especially at the centre; the problem of equitable employment to members of all sectors or all constituent units in the federation; location of industries or infrastructures and projects especially those funded by the federal government and the sharing of resources or what is known in Nigeria as revenue allocation. Each of these four is related to the whole gamut of the political economy of federalism. Any lapse in one or more of these factors can mar any federal system especially a fragile federation with a dependent capitalist polity like Nigeria.

The debate on Nigeria's fiscal federalism and relations hinges on the fundamental question of who gets what of the national cake, when and how. This is fundamental given that Nigeria as a monolithic economy gets over 80% of its revenue from crude oil, by virtue of the constitutional provision, this revenue must be disbursed to the three tiers of government. It also explains why the formula for revenue allocation has continued to be at the heart of public debate and why public office holders are hardly held accountable for the misuse of revenues derived from the national oil wealth. It is obvious that the nature and conditions of the financial relations in any federal system of government is crucial to the survival of such a system. A major source of inter-governmental disputes under a federal system centres on the problems of securing adequate financial resources on the part of the lower levels of government to discharge essential political and constitutional responsibilities (Olaloku, 1979:109). In all federations, there are always constitutional wrangling or how resources should be shared among the constituent units since there are always poor and relatively rich units for instance, in Nigeria, the poor units/regions/states often prefer a re-distributive system of federal resource while the richer or more endowed States are in favour of more financial autonomy and revenue allocation based on the relative contribution of each constituent units to the federal purse.

By and large, the political economy of fiscal federalism strikes at the very basis of the existence of the Nigerian federation and the incessant clamour for resource control and the cacophonous calls for restructuring of the polity attest to the veracity of the argument that the country's fiscal federalism is bedevilled by series of contradictions which need urgent attention to avoid a disintegration of the polity. The reforms in the national sharing of resources between 1967 and 1975 effectively neglected the politics of the dominant class because oil formed substantial revenue base of the country (Obi; 1998:261). Therefore, it is the oil revenue that has brought about the current struggles over the control, access and distribution by various factors of the ruling class. The principle of derivation, if allowed to be the basis for determining revenue allocation, will unduly favour some parts of the federation at the expense of the others.

This explains the reason why Obi (1998) posits that the Federal Government as the very vortex of power thus becomes the ultimate prize in politics and all attention shifted to the contest for access to power and the capacity to authoritatively allocate resource at the centre. This centralization of power and resources is antithetical to true fiscal federalism. The concentration on oil revenue also militates against the improvement of other sectors of the economy. In Nigeria revenue allocation largely implies the allocation of oil revenue, therefore, oil is central to the politics of inter-governmental fiscal relations thus the contending forces over power and access to oil, extraction and accumulation of resources constitute the major



conceptual issues that must be objectively confronted in seeking to understand the political economy of fiscal federalism in Nigeria.

Challenges of Fiscal Federalism in Nigeria

The major challenge of fiscal federalism is to ensure equitable distribution of resources to all groups that make up the nation and at the same time, guarantee that the geese that lay the golden eggs are adequately rewarded. There are several challenges tormenting intergovernmental fiscal relations in Nigeria which according to Ekpo, (2009) include: Non-correspondence problem; fiscal Autonomy and Independence; federation account and the derivation fund; oil-producing areas and the derivation principle and intergovernmental fiscal relations and the economy.

A critical foray into the oil-producing areas and the derivation principle brings to bare the fact that crude oil production has been the most important economic activity on the Nigerian economy since the early 1970's. Its impact is not limited to its contributions almost 90% of Nigeria's total foreign exchange earnings but also to the fact that the national budgets are predicated on the expected annual production and price of crude oil. This crude oil is the primary engine for national economic growth and development. It is therefore, quite reasonable to expect that the areas producing the nation's crude oil would be very highly developed as compensation for what is taken away as well as for the devastation on the land engendered by the exploration process. There should have been development of physical and social infrastructures, human capital creation and economic empowerment of the general citizenry in those areas. The Niger Delta area suffers near total neglect by both the federal government which claims ownership of the oil and multinational companies which actually exploit the oil reserves.

The intervention of the federal government through the Niger Delta Development Commission (NNDC) seems to be a welcome development. However, the missing factors seems to be the proper treatment of the derivation principle in a way that would enable the State and local governments of the oil producing areas to handle their developmental problems according to their own felt needs and priorities. The minimization of the derivation factor over the years from the earlier 50% to 1% and now 13% only as it affects crude oil is unjust and unfair (Ekpo, 2004). The challenge will be to re-examine the issue of derivation particularly in line with the new democratic experiment.

Typically, the challenges of fiscal federalism in Nigeria hinge on the equity of the expenditure assignment and revenue-raising functions amongst the three tiers of government. The revenue sharing and expenditure assignment formula has been generally inadequate in addressing the needs and resource gaps in the three tiers of government. The strategy and institutional arrangement for redressing the mismatch have been approached incrementally over the years. Beginning with the era whereby a committee was appointed every five years to make recommendations regarding fiscal responsibilities among the tiers of government, the 1999 constitution of the Federal Republic of Nigeria, under the third schedule, provide for the establishment of a body known as the Revenue Mobilization Allocation and Fiscal Commission. While there is an apparent disconnects arising from expenditure and revenue responsibilities, this has not been as visible and controversial as the system of transfers or sharing of the national revenue. The sharing formula is based on arcane principles such as equality of states and



landmass. Why should the States be equal in consumption and unequal in production? And why should a huge landmass of unfertile and unproductive soil be rewarded more than a small landmass of fertile and productive soil? Considering this foregoing arguments, the major challenge of fiscal federalism is to ensure equitable distribution of resources to all groups that make up the nation and, at the same time guarantee that the geese that lay the golden eggs are adequately rewarded.

Concluding Remarks

Nigeria's fiscal system over the years has been characterized by misplaced expenditure priorities; inequitable appropriation of the nation's revenue and excessive fiscal centralization. No doubt, fiscal federalism has been a perennial problem, particularly because of different levels of resource endowments among the different levels of government and partly because of inter group struggles to have adequate and fair share of the central revenue. The persistent agitation for resource control by the rich states and ethnic minorities of the South-South geopolitical Zone can be ignored only at great cost to national unity.

Against this background, there should be a redefinition of the statutory roles of each tier of government and a modification of the current jurisdictions and the need to revisit the old revenue sharing and expenditure assignment formula. In particular, there is a need to assign less weight to criteria such as landmass, because of its inherent inequality and redistributive distortions. More so, there is need to adopt a strategy which will make the sub-national government less dependent on the central government and looking inwards for fiscal sustainability will restore social contract and improve service delivery in the sub-national government. Similarly, emerging criteria such as equality of state and population into one should be given serious consideration, since they are essentially duplicative.

Moreover, the inter-tier distribution of revenue has been lopsided and the revenue allocation criteria often reflect sectional, rather than national interest. The two lower tiers of government have been treated like mere appendages with highly restricted revenue powers rather than a part of a truly federal system whose fiscal autonomy is guaranteed. Their marginalization, as evident in incessant curtailment of revenue powers, heavy dependence on the federation account and limited fiscal jurisdiction in general, can and do affect the viability of many States and thus constitute a threat to national stability. To correct the situation, there should be redefinition of the statutory of role each tier of government and a modification of the current fiscal jurisdictions. These changes must be reflected in the new Nigerian constitution amendment if the country is to achieve fiscal sustainability, balanced development and equitable distribution of the federation revenue in the years ahead.

There is no doubt that the principles of fiscal federalism implicitly or explicitly have guided the formation and implementation of fiscal relationships among the different tiers of government. There should be adequate compensation for those who provide the common wealth and all stakeholders must be committed to fine-tuning the process in the overall interest of the country.

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